

Financing For Infrastructure Development: The Case of Ho Chi Minh City, Vietnam

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I. BACKGROUND

Vietnam has achieved impressive results since the introduction of the "doi moi" (renovation) policy in 1986: growth has been strong, inflation has been brought under control and progresses have been made in the transition to a market economy. Contribution to these successes came from Ho Chi Minh City (HCMC), the largest socio-economic-cultural-financial center of the country. Although HCMC's population accounts for only 6.4% of the total national population, it accounts for 18.2% of total national GDP and 29.3% of total national industrial output. The population has been tremendously increased during the last few decades, both due to natural growth and immigration. As the socio-economic development takes place, especially in the industrial and service sectors, the infrastructure system of the city has become insufficient and tremendously degraded. Roads and streets are overloaded and jammed, the water and electricity supply are insufficient, both qualitatively and quantitatively. The outdated and degraded drainage system, in addition to weak management and maintenance, has resulted in serious environmental pollution. At the same time, investment in social infrastructure development is not compatible to the size of the city, and can not satisfy the demand of development. Due to the low investment and high population, the per capita investment in social infrastructure is low. Facing these difficulties, the city's government has been looking for capital in order to improve the City's infrastructure systems. The capital market of HCMC can be divided into 4 sources, which can be used to promote the development of the city: government budget (central and local budget); capital from state-owned enterprises (SOEs) due to self-accumulation and reinvestment; capital from public savings and private investment; overseas capital including foreign direct investment (FDI), official development assistance (ODA), and loans from international institutional organizations. The government budget is mainly spent on improvement and development of infrastructure system and other spearhead industries, accounts for about 10% of the total investment capital in HCMC. The capital from SOEs, accounts for 25%, depends mostly on the government's mechanism and policies, which facilitate the efficient investment of entrepreneurs and encourage the capital accumulation for reinvestment. This financial source includes the self accumulated and reinvested capital of enterprises mainly in the public sector and the government capital share in the joint stock or joint venture companies. 80% of this source has been used to complement to the floating capital and 20% spent on new equipment. The capital from public savings and private investment also contributes to the development of the city, accounts for about 30% of the total investment capital of the city. Due to its high potential, this source is increasingly of concerns for infrastructure development in the next decade. In order to mobilize this financial source, it is necessary to have proper mobilization policies. The overseas capital, especially the FDI and ODA, accounts for high percentage of total investment capital in HCMC (35%). The ODA is mainly used for the development of infrastructure rehabilitation, upgradation, and extension, however, it

accounts for a very small percentage in the infrastructure development of the HCMC. Confronting its weaknesses in infrastructure systems, the City's government has imposed many measures for the city's development. Upgradation of the existing infrastructure system and development of new infrastructure have been targeted. The City's government has set the priority for investment in upgrading and developing the technical and social infrastructure systems to catch up the economic growth rate sustainably. In order to utilize the above-mentioned sources of capital market, the government had tried many options for infrastructure development. The Investment Fund of HCMC (similar to municipal development funds) has been recently established to manage all capital sources funding for direct or indirect investment in socio-economic development of HCMC. The municipal bonds approach was tried in the Nguyen Tat Thanh Road Repair and Upgradation Project. This paper will look at these cases and its implications to the infrastructure development of HCMC.

II. IMPLEMENTATION

During the past, the main source of capital for city infrastructure development came from the government budget. Investment in transportation, telecommunication, etc. accounted for almost 17% of the total investment capital in basic construction and large repair, graded as the second largest investment after processing industry during 1991-1995. The investment was focused mainly on upgradation and improvement of telephone lines, facsimile and telex systems. Investment in health, social security, education and training was low, only accounted for about 4% of the total investment capital in basic capital in basic construction and large repair. The source from ODA has been insignificant in HCMC's infrastructure development in the past, however ODA has been increased within the last few years, mainly for the water supply sector. Due to limited government budget, HCMC has actively searched for new financial options for its development. The Investment Funds and Municipal Bonds for the Nguyen Tat Thanh Road Repair and Upgradation are the two examples.

1. Investment Fund of HCMC (IF)

This is a very new form of financing for infrastructure development in HCMC, which was chosen to be the pilot study for the whole country. Since it was established only few months ago, not much was done with this fund. This is a public institution, which has its own legal status, its own seal and is allowed to open an account at the State Treasury and at other local or international banks. When it is necessary, this fund can open branches in other provinces or in other countries, based on the related regulations. The organization of this fund includes the Board of Trustee, Board of Management, Director of the IF and staffing board.

The IF has three main functions:

To carry out its right of using and managing all capital resources, funding sources and assets trusted by the government; To utilize efficiently all capital resources, funding sources and trusted assets in investment of urban infrastructure development of HCMC. To organize and coordinate

direct or indirect investment activities and provide services to satisfy partly the capital needs of the socio-economic development of HCMC and to ensure the development of its financial potential.

The IF has responsibilities such as to receive, protect and develop all capital resources, funding sources and trusted assets; to conduct long term strategic development plan, five-year plan and annual plan of the IF; to select new investment projects, joint-venture projects; to use efficiently and is in charge of paying back loans and interest of credits loaned by the IF or international credits as trusted by the government; to fulfill the regulations on taxation and other financial responsibility generated from the fund's activities; to undergo the investigation and control of state management agencies and is responsible for all its activities.

The sources of IF's capital come from: the initial capital from the City's government, the additional capital from the City's budget, the investment trust capital from the City's budget, capital from local mobilization, capital from foreign loans, and other sources of assistance. The initial capital of the IF is 500 billions VND (equivalent to more than 45 millions USD).

The IF can suggest to the City's People's Committee (PC) on the development strategies, action alternatives and organizational structure of the IF. It is allowed to mobilize capital from different sources such as to issue medium and long term bonds, to get credit loans from local and international agencies and to receive investment trust capital. It can also participate in the appraisal of foreign investment, decide on stock investment by its idle capital and can have direct or indirect management of other investment funds. As stated in the Fund's charter, the IF can lease the land, assets from the government on a long term basis to established its initial capital, and use them for mortgage when it gets loans from local or foreign banks.

The organization of the IF consists of the Board of Trustee, including 5 members (with a five-year term) who are assigned directly by the Chairman of the City's PC, based on the nomination of the Department of Finance and the City's Organizational Board; the Board of Management, including 3 members assigned by the Board of Trustee for a five-year term; a Director and a staffing board. The Director is nominated by the Board of Trustee and is approved by the Chairman of the City's PC.

IF is allowed to mobilize different sources of capital for financing projects of infrastructure development in HCMC which can be divided into three categories: those projects which are profitable and of high capital recovery and with interest rate higher than inflation rate; those projects which are not profitable but the investment capital can be recovered; and those projects without capital recovery (the projects get the investment capital from the government's budget). Therefore the IF can use only 5% of its registered capital to invest in the third category projects, 20-25% to invest in the second category projects and 70-75% to invest in the first category projects. At the same time the IF can temporarily invest in different types of stocks to avoid unused capital storage.

Since the IF is a public institution belonging to the state economy system, it is under the superintendence of state agencies relating to the IF's activities such as the City's PC, the Ministry of Finance, other Ministries, the City's Board of Organization, the District's or Ward's PC and other financial/credit agencies. To the HCMC's PC, the IF is under the supervision of the Chairman of the City's PC, receives the capital sources from the city's government, proposes and carries out the medium and long term development strategies and plans as well as large investment projects. The IF has to comply to all legal documents relating to its activities, be responsible for the any legal violations (if any) and can suggest measures, mechanism and policies to manage the IF efficiently.

2. Municipal Bonds For The Nguyen Tat Thanh Road Repair And Upgradation Project

Municipal bonds is a tool that has been used widely by different companies and government in the world, however this option of financing for infrastructure development is quite new to Vietnam. HCMC has a great demand of capital in infrastructure rehabilitation, upgradation as well as development, however, the city's budget is limited, only available for part of infrastructure repair, and is incapable for new infrastructure development. Since municipal bonds proved to be quite effective in funding for infrastructure development, HCMC was selected as a pilot project for the country in applying this tool of finance in 1994.

The municipal bonds were issued to raise capital for the Rehabilitation and Upgradation of the Nguyen Tat Thanh Road Project. The Minister of Ministry of Finance signed a Decision on Municipal Bond Issuance in HCMC (decision no. 290-TC/QD/KBNN, dated 8/4/1994) with the total value of 30 billions VND, on a 3 year term and the annual interest rate of 12%. There were 3 types of par values: 500,000, 2,000,000 and 10,000,000 VND. The buyers are either local enterprises of different economic sectors, enterprises with foreign investment capital operating in compliance with the Law on Foreign Investment or Vietnam financial organizations (such as the commercial banks, credit agencies, insurance or financial companies) or Vietnamese residents, foreigners who are working and living in Vietnam.

The bond's value will be paid on maturity (after 3 years) and is not allowed to be paid before the maturity. The interests have been paid once every 6 months, and the total repayment for the bond's value and the interest will be covered by the toll fee. The fee was decided by the HCMC's PC in agreement with the Ministry of Finance. The total cost of issuance was covered by the city's budget, including cost of printing, operation cost of issuance and repayment, cost of training and advertisement and other related costs.

To implement the municipal bonds, there are many governmental agencies involved. Firstly, the HCMC's PC is responsible for having documents guiding the implementation, managing and using efficiently the raised capital, organizing the fee collection, allocating the source for repayment, and coordinating with the Ministry of Finance in evaluation the implementation of municipal bonds. The Department of Finance and Price Committee of HCMC are responsible for receiving

and managing the revenue from bond issuance, coordinating with the Department of Planning and Investment in using and allocating the revenue, allocating the city's budget to repay on maturity, monitoring the use of revenue. The Treasury Agency is in charge of receiving and monitoring the bonds printed by the Ministry of Finance, distributing the bonds to agencies responsible for the issuance, organizing the sale of bonds, collecting the revenue for the local budget and managing, accounting and reporting the implementation. Lastly, the Department of Communications, Transportation and Public Works is responsible for managing and using the revenue invested in the project, summing up all the expenses to the Department of Finance and Price Committee, collecting the fees and submitting the revenues to the local budget.

In reality, when the project was implemented, many issues generated. Firstly, the total amount of money raised by the bonds was 25,733 millions VND, compared to the expected 30,000 millions VND. The reason was that the bonds were sold too early while the preparation for rehabilitation and repair were not ready (bonds were sold 6 months before all the work started). There was a loss to the government due to the interest paid for the first 6 months while the work was not carried out, the government then stopped issuing the bonds and covered the remaining expenses by the city's budget. Secondly, the bonds were supposed to target at the Vietnamese residents. The reality showed that 90.2% of the bonds were sold to different banks, 9.7% sold to enterprises and only 0.1% sold to individuals. As stated at the beginning, municipal bonds are quite new to Vietnamese, therefore their understanding and trust in the bonds were not set up. Thirdly, the total cost of the project was 41.8 billions VND compared to 30 billions VND as expected. The expected cost had under-evaluated, resulting in the extension of fee collection duration. The fees has been collected since the completion of the project in April 1996, and the monthly average revenue since then was about 1.5 billions VND.

III. NEXT STEPS

The above-mentioned financial options implemented by the HCMC's PC are the two study cases for the whole country. Since the IF has just been established, no conclusion or evaluation about its implementation could be drawn at the present. In the next few years, it is necessary for the city's government to evaluate the implementation of this option and draw the experiences for the country. Different experiences from other countries would be good examples for considerations, especially in the implementation process. In the next few years, there will be sources of ODA for infrastructure development in HCMC, especially in the water supply sector. The financial assistance will come from the French government, the Asian Development Bank (ADB) and the Canadian International Development Agency (CIDA). These aids will aim at the upgradation and improvement of the water supply system, and the urban transportation and the feasibility of the new bridge over the Thu Thiem River in HCMC. As ODA is included in the IF, improving the legal framework to attract more FDI and ODA is of great demand for the government.

The main source of city government's budget comes from taxation (about 90%) therefore tax policy plays an important role in raising the city's revenue. In the last decade, under the

renovation policy, there have been many measures and policies implemented in taxation, however, the tax system is not comprehensive. It is necessary for the government to continue its consistent reform and renovation in the tax system, tax mechanism and policies, reorganization of administrative bureaucracy and the tax collection system. Decentralization in revenue allocation to the city's government will enhance its flexibility in mobilizing more revenues and in utilizing the budget more efficiently.

Although there has been only one case of municipal bonds for infrastructure development in HCMC, in the future there might have more applications of this financial tool. There are many experiences that could be learned from this pilot study for future successful implementation. First, concept on municipal bonds should be widely delivered to the Vietnamese. In the past, bonds have been already issued by the government to mobilize capital for certain development projects, however, the residents have not had trust in the government bonds. The condition for having municipal bonds becomes more difficult since there is no stock market in Vietnam, and the experiences of long-term bonds issued previously showed that it was very difficult to attract the buyers. With good knowledge on municipal bonds, the residents will have strong intention to buy the bonds. Second, the government should ensure the benefit of those who are able to buy the bonds, as well as the repayment of interests and initial capital. Experience from the Nguyen Tat Thanh project showed that the government fulfilled the repayment quite well. The case should be multiplied and presented to the people to attract their participation in implementing the municipal bonds. Thirdly, there should be good preparation for the issuance of the municipal bonds: when to issue, what is the total value needed to mobilized, what is the interest rate (this is very important, since it will decide the buyers' benefits, resulting in their participation, and should include the inflation rate). The bond issued agency has to calculate and, based on the forecast of the socio-economic development of the city, to give a reasonable and attractive interest rate to the buyers. The bonds can only be issued once the project's capital sources have already been defined, of which municipal bonds are one source, in order to avoid the extension of the project's time, and to avoid money waste due to interest payment to the mobilized capital that has been used inefficiently or has not been utilized.